

TESTIMONY of NIGEL MORRIS  
CO-FOUNDER and VICE-CHAIRMAN  
CAPITAL ONE

*Answering the Administrations Call for Postal Reform*

BEFORE the  
House Committee on Government Reform  
Special Panel on Postal Reform and Oversight

February 11, 2004

## **INTRODUCTION**

Chairman McHugh and Members of the Special Panel on Postal Reform and Oversight, thank you for the opportunity to share Capital One's views on the growing need for effective reform of the United States Postal Service ("Postal Service"). The financial services industry is one of the Postal Service's most important customers and ensuring a healthy future for the Postal Service is of great importance to Capital One and others in our industry. We appreciate the commitment made by you and Ranking Member Davis, along with the Chairman Tom Davis and Ranking Member Henry Waxman of the Committee on Government Reform, to making postal reform a top priority for the second session of the 108th Congress.

Capital One® Financial Corporation is a publicly held holding company based in McLean, Virginia. A Fortune 200 company, Capital One has over 47 million accounts, \$70 Billion in managed loans and 17,000 associates. As one of the world's largest issuers of Visa and MasterCard, Capital One is best known for its low rate credit cards, however the company also offers a variety of lending and deposit products including auto loans, installment loans, CD's, money market and IRA's. Integral to the success of our business model is the United States Postal Service. The mail channel is our primary distribution channel for communicating with current customers and making offers to potential customers. In 2002, Capital One ranked as the largest producer of First-Class mail in the United States. Our postage spend was in excess of ½ billion dollars, accounting for over 1% of all mail volume of the USPS. By all measures this is our largest supplier relationship.

Our views today are strongly shared by the Financial Services Roundtable, an organization representing 100 of the nation's largest integrated financial services companies which provide banking, insurance, securities, and investment products and services to American consumers. Roundtable member companies provide fuel for America's economic engine, accounting directly for \$12.4 trillion in managed assets, \$561 billion in revenue, and 1.8 million jobs. In light of the increasing financial instability at the Postal Service, the Financial Services Roundtable commissioned a study in May 2003 entitled "Creating a Customer Focused Postal Service." This study concludes that a substantial overhaul of the Postal Service is the only way to secure its long-term success.

Our views are also shared by the National Postal Policy Council, of which Capital One is a member. Representing many of the nation's largest business

users of First Class mail, NPPC has members in the banking and financial services, utilities and telecommunications, insurance and other industries. Collectively, NPPC members account for an estimated 40 billion pieces of First Class mail annually, which is more than 40% of 2004's projected 97.9 billion pieces.

Jobs and mail go together. The mailing industry contribution to the economy amounts to about \$900 billion in economic value or about 8 percent of GDP. Of the 137.6 million people employed in America today, nine million jobs are directly connected to the mailing industry. That represents six percent of all jobs. The mailing industry is an important primary and secondary employer and a vibrant and healthy Postal Service is critical to the U.S. economy, the financial services industry, and to the future of Capital One.

We are very pleased that President Bush has formally urged Congress to act quickly on postal reform this year. We agree strongly with the five overarching principles of postal reform laid out by President Bush in December 2003, including the principles of best practices, transparency, flexibility, accountability, and self-financing. We would also like to recognize the hard work of Chairman McHugh for championing the Postal Reform effort in Congress. In 2002 Chairman McHugh introduced a bill (HR 4970) that encompasses the principles outlined by the Administration. I understand this bill will form the basis for legislation he intends to introduce soon and wholeheartedly support the concepts he has embraced in his legislation.

The principles outlined in the recent call for action from the White House echo the recommendations of the findings of the President's Commission on Postal Reform. Our company and the financial services industry have also carefully assessed the July 2003 report issued by the President's Commission and, as described below, we enthusiastically support many of the Commission's recommendations for legislative and administrative reforms needed to ensure the viability of the Postal Service.

We expressly call on Congress to heed the Commission's recommendations to allow the Postal Service to spend savings accrued from changes in its Civil Service Retirement System (CSRS) obligations. Abolishment of the escrow provision of the Postal Civil Service Retirement System Funding Reform Act (Public Law 108-18) will improve the Postal Service's revenue and rate planning. This is a top priority for Capital One and the Financial Services Roundtable and we urge the Committee to take swift action to correct this problem. The substantial rate increases that will result if action is not taken

would have significant financial impact to the mailing community, the financial services industry, and the nation's overall economy.

Fortunately, Congress now has the opportunity to prevent large rate increases by addressing the CSRS issue, together with comprehensive postal reform. Capital One and the Financial Services Roundtable believe that the pieces are in place for the Postal Service to be reformed into an organization that operates like a business focused on providing quality and affordable services and working with its customers to develop new and innovative products. We appreciate your leadership in promoting the meaningful systemic changes that will enable the Postal Service to better serve its customers, control costs and maximize efficiencies for the long term. These reforms will, in the long-run, protect jobs and allow U.S. businesses to flourish.

#### **THE POSTAL SERVICE IS IMPORTANT TO CAPITAL ONE AND THE FINANCIAL SERVICES INDUSTRY**

A healthy future for the Postal Service is essential to Capital One and to the financial services industry. A study conducted on behalf of the Financial Services Roundtable found the financial services industry generates and receives as much as 25% of all mail handled by the Postal Service. Considering mail both sent and received, the financial services industry is one of the Postal Service's most valuable customers. We recognize that businesses need stable postal rates in order to facilitate a multitude of investments that will grow the economy. With the right conditions, the private sector will continue to grow, invest, and create jobs.

The financial services industry has grown substantially since the 1980s when a series of moves to deregulate the industry began. In large part, this growth has occurred because deregulation has permitted new products and services to be offered and new entrants to participate in the industry.

The Postal Service also played a key factor in our growth. The USPS provides a convenient, relatively cost effective, tool to communicate with new and existing customers (billing statements and other important account information) and consumers about new products and services. For new entrants, like Capital One, the mail channel has been critical.

As a result, financial services markets have become more innovative and competitive and American businesses and consumers have benefited from improved, lower-cost, and friendlier financial arrangements.

PriceWaterhouseCoopers projects that the financial services market will grow 81% between 2001 and 2010 – from less than \$3 trillion to almost \$5 trillion.<sup>1</sup> This no doubt reflects the stimulus for growth and innovation -- through competition -- that comes through the use of individualized offers in the mail.

### **NEGOTIATED SERVICE AGREEMENTS (NSA)**

Because mailing is such an integral piece of Capital One's business, we were very pleased to be the first company to sign a Negotiated Service Agreement with the Postal Service in June 2003.

The Negotiated Service Agreement (NSA) is a pricing strategy that gives the USPS the ability to customize its service offerings and rates to address customers' unique mailing needs and encourages cost-efficient behavior. This is standard practice in the business community. Under current law, NSAs are one of the few ways the Postal Service can pursue pricing flexibility, which is a critical element of postal legislative reform.

This first NSA features cost savings for the Postal Service by returning undeliverable mail to Capital One electronically instead of physically. This alone is estimated to save the Postal Service \$40 million over the term of the agreement. Capital One has also agreed to address quality standards well above those required by postal regulations. In return, Capital One receives discounts on First-Class Mail volume above an annual threshold of 1.225 billion pieces.

Providing price incentives for mailers to encourage more mail volume and best practices will help make it possible for the Postal Service to keep rates affordable for everyone. The volume incentives in the NSA help foster increased use of First-Class Mail by Capital One, which helps pay for overhead costs that support the entire mail system. Pricing innovations like NSAs will drive more volume and revenue helping the Postal Service preserve universal mail service which is fundamental to the American way of life.

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<sup>1</sup> PriceWaterhouseCoopers (2001)

## **IMPROVEMENTS NEEDED TO MAKE POSTAL REFORM MEANINGFUL**

### **THE POSTAL SERVICE'S BUSINESS MODEL HAS NOT KEPT PACE**

I would like to thank Jack Potter for his hard work. Since taking over the reigns of the Postal Service, he has made great strides, working with all stakeholders trying to improve the Postal Service's financial footing. In 2003 he reduced costs by \$1.1 Billion and for the fourth consecutive year has shown positive productivity gains. Equally as important he has designed and implemented a pay for performance program for every supervisor, postmaster, manager and executive of the Postal Service.

While the Postal Service has served the mailing industry well in the past, its current business model is an impediment to its financial stability. Created by the 1970 Postal Reorganization Act the USPS has seen tremendous innovation in the business world and marketplace. Unfortunately the USPS has lacked the flexibility to change with today's fast-paced economy, hindering its ability to meet the changing needs of its customers. The Postal Service needs to engage in a more modern, flexible, and responsive business model. The new business model selected must serve the needs of taxpayers, employees, competitors and most importantly customers.

Taxpayers currently hold all liabilities associated with the Postal Service, so it is in their interest that the business model offers the greatest chance that the liabilities are paid by customers of the Postal Service. Employees need a business model that gives them the best chance for success in the future. Customers need a business model that encourages competition, efficient management and innovation.

Capital One and the Financial Services Roundtable would like to express our strong appreciation for the work being done by this panel. Postal Reform is a complex issue and your commitment is greatly appreciated. The Administration has been a strong supporter, appointing a Presidential Commission to study the Postal Service and recently announcing its support for legislation based on its five postal principles. However, the champion of postal reform that deserves special recognition is Chairman John McHugh. You have continued to press for postal reform for years and we thank you. More importantly you have devoted the time to craft thoughtful legislation in the past. You should be proud of the fact that the legislation you crafted nearly 2 years ago has all the same principles identified by the Presidential Commission and encompasses the five postal principles of the Administration.

Mr. Chairman thank you and we support your efforts to craft legislation that will bring the Postal Service into the 21<sup>st</sup> Century.

### **IMMEDIATE REFORMS NEEDED**

In addition to the long-term systemic changes that need to be made to the Postal Service's business model, Capital One and the Financial Services Roundtable strongly support some immediate reforms. We urge Congress to take swift action to eliminate the escrow provision of the Postal Civil Service Retirement System Funding Reform Act providing the Postal Service greater financial flexibility to implement the needed reforms required to create a financially stable Postal Service. We also believe the Postal Service should be relieved of any obligation to pay retirement benefits of postal employees earned through military service.

### **ABOLISH THE ESCROW PROVISION OF PUBLIC LAW 108-18 AND ALLOW THE POSTAL SERVICE TO SPEND SAVINGS ACCRUED FROM CHANGES TO ITS CIVIL SERVICE RETIREMENT SYSTEM OBLIGATIONS**

The Postal Civil Service Retirement System Funding Reform Act was an important step toward allowing the Postal Service to use overpayments of its CSRS retirement obligations to reduce its debt to the Treasury and keep postage rates down. Unfortunately, the Act calls for Congress to hold the surplus in escrow after 2005. As the Presidential Commission has recommended, we urge Congress to abolish the escrow account as it will impede the Postal Service's revenue and rate planning, and will immediately trigger higher postal rates for all users in 2006.

The Postal Service has stated that failure by Congress to remove the escrow will by itself cause a 5.4% rate increase in 2006, and even larger increases in later years. Studies show that a penny increase in postal rates will cause a one-half of one percent volume decline in mail at the Postal Service. A five percent increase in rates would generate a 1.175 billion unit loss in mail volume or \$270 million loss in revenues. Experts have estimated that if the CSRS provision is not fixed, it would mean a 12 percent increase in rates just to pay for CSRS and normal operating costs. Fixed costs could not be covered and we could be looking at another deficit of \$2 billion by 2006. We strongly encourage Congress to address and resolve all aspects of the Postal Service Civil Service Retirement System.

**RELIEVE THE POSTAL SERVICE OF THE OBLIGATION TO PAY  
RETIREMENT BENEFITS OF POSTAL EMPLOYEES EARNED  
THROUGH MILITARY SERVICE**

We also believe that Congress should relieve the Postal Service of the obligation to fund the military service component of its CSRS retirees' pension payments that was included as part of the Postal Civil Service Retirement System Funding Reform Act. As the majority of these costs relate to military service performed before the creation of the Postal Service and because this decision is inconsistent with every other federal agency, we agree with the Presidential Commission's call to promptly return responsibility for this portion of retiree benefits to the Department of the Treasury.

**THE POSTAL SERVICE MUST IDENTIFY INNOVATIVE  
OPPORTUNITIES TO INCREASE VOLUME AND REVENUE**

The Postal Service needs greater flexibility to partner with business to increase volume and revenue. Capital One's NSA is a prime example of the type of solutions that can be developed providing a benefit for everyone involved, the Postal Service, mailer and mailing industry. By creating innovative products and services and being allowed the flexibility to efficiently implement these products and services, the Postal Service can increase the value of their business and grow revenue. This is a win-win for the Postal Service and its customers.

**THE POSTAL SERVICE MUST RATIONALIZE ITS NETWORK**

The Postal Service should be encouraged to right size their network and eliminate redundancy and excess capacity. As stated in the commission's report, "With mail volumes stagnant, with opportunities to outsource and provide better service at less cost, and with less fixed infrastructure to maintain, the Postal Service has significant opportunities to rein in the costs of its logistics network."



## **THE POSTAL SERVICE MUST KEEP PACE WITH TECHNOLOGY**

In order to continue to support economic growth and ensure the American pillar of universal postal service, the Postal Service must take ownership of the technological advances that are needed to ensure the vitality of the Postal Service. Communications through faxing, harnessing of computer technology, online bill payments, and emailing are all daily challenges to the Postal Service. The Postal Service faces significant constraints to the effective use of technology because of its (1) non-standard operating plans and processes; (2) weak basic information infrastructure; and (3) limited investment capital. These constraints and challenges will only be effectively addressed through a more nimble and business oriented approach focused on the effective use of available resources to maximize the benefits to the Postal Service.

## **CONCLUSION**

In conclusion, Mr. Chairman, Capital One and the Financial Services Roundtable would like to thank you, Ranking Member Davis, as well as Chairman Davis and Ranking Member Waxman for making postal reform a top priority for 2004. In light of President Bush's recent call for action, the time has never been better for achieving meaningful reform. We fully support your approach to postal reform which adheres to the guiding principles set out by the President, and we strongly urge Congress to take quick action to abolish the CSRS escrow provision. We also support legislation that would relieve the Postal Service of the obligation to fund the military service component of its CSRS retirees' pension, give Postal Service management more flexibility in negotiating NSAs, and allow the existing rate structure to be replaced by an incentive-based structure.

The size and complexities of the Postal Service dictate that true reform will require a long-term view and patience. It is worth noting that it could provide a model or set a standard for improving other government functions providing for improved government services at lower costs for taxpayers. However, action is needed now to begin the process. As postal reform progresses, Capital One, the members of the Financial Services Roundtable and the members of the National Postal Policy Council look forward to continuing to work with the Committee to swiftly enact the reforms needed to sustain a viable Postal Service that can maintain affordable rates and efficient services.

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